

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-10 ISO-00 NEA-10 PA-01 IO-13 AID-05
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USADB

PASS TREASURYDEP FOR SHERK

FOR NAC AGENCIES

EO 11652:NA
TAGS: EAID, EFIN, ADB
SUBJECT: REVIEW OF ADB LENDING RATE

REF: MANILA 11485

1. U.S. EXECUTIVE DIRECTOR AND ALTERNATE DIRECTOR HAVE MET WITH ADB CONTROLLER AND TREASURER TO OBTAIN FROM THEM ADDITIONAL REASONING BEHIND ADB MANAGEMENT PROPOSAL TO HOLD BANK LENDING RATE TO PRESENT 7.70 PERCENT FOR REMAINDER OF YEAR DESPITE RECENT IBRD DECISION TO INCREASE ITS LENDING RATE FROM 7.50 PERCENT TO 7.90 PERCENT, EFFECTIVE JULY 1.

2. CONTROLLER SAID THAT THE OVERALL BORROWING COSTS IN CAPITAL MARKETS DURING THE PAST SIX MONTHS HAVE BEEN MUCH LOWER THAN THE BANK'S LENDING RATE. THE IBRD
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LENDING RATE IN THE LAST CALENDAR QUARTER BASED ON THE COST OF ITS PROSPECTIVE BORROWINGS DURING THIS QUARTER AND BY APPLICATION OF ITS FORMULA IS LIKELY TO GO DOWN TO 7.50 PERCENT OR EVEN LOWER. IF THE BANK WERE TO INCREASE ITS LENDING RATE NOW AND THEN REDUCE IT IN THE LAST CALENDAR QUARTER, THERE WOULD BE A SERIOUS "BUNCHING" PROBLEM, AS DMCS WOULD SURELY ANTICIPATE THE

CHANGE AND HOLD UP ON PROJECT LOANS UNTIL THE LAST QUARTER.

3. STRICT APPLICATION OF THE BANK'S FORMULA, ACCORDING TO THE CONTROLLER, BASED AS IT IS ON NORMALIZED BORROWING COSTS WOULD ACTUALLY LEAD TO A REDUCTION OF THE BANK'S LENDING RATE. HOWEVER, SUCH ACTION COULD NOT BE CONSIDERED FEASIBLE WHEN THE IBRD INCREASED ITS LENDING RATE, UNLESS IT CAN BE MADE CLEAR TO ALL CONCERNED, PARTICULARLY THE INVESTORS IN THE BANK'S BONDS, THAT THE IBRD INCREASE IS A "FREAK PHENOMENON."

4. THEREFORE, THE CONTROLLER CONCLUDED, THE PROPOSAL NOT TO CHANGE THE BANK'S LENDING RATE AT THIS TIME IS THE MOST LOGICAL, REALISTIC AND OPERATIONALLY APPROPRIATE ONE, HAVING PARTICULAR REGARD TO THE CHANGE THAT COULD BE ENVISAGED IN THE IBRD'S LENDING RATE IN THE LAST QUARTER OF THIS YEAR. HE ALSO NOTED THAT THE IDB BOARD OF DIRECTORS HAS DECIDED NOT TO CHANGE ITS LENDING RATE FROM 7.50 PERCENT FOR THE REST OF 1978, NORWITHSTANDING THE FACT THAT STRICT APPLICATION OF ITS FORMULA WOULD HAVE CALLED FOR A REDUCTION. EVEN SO, THE LATTER'S LENDING RATE IS NOW THE LOWEST AMONG THE THREE MULTI-LATERAL DEVELOPMENT BANKS.

5. THE ADB TREASURER OBSERVED THAT, EVEN IF THE BANK HAD LIMITED OFFICIAL USE

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GONE TO THE U.S. MARKET IN THE LAST QUARTER FOR A 25-YEAR PUBLIC ISSUE, THE HIGHER COST ON THIS BORROWING (ABOUT 9-1/2 PERCENT) WOULD HAVE HAD ONLY A MARGINAL EFFECT ON THE BANK'S OVERALL NORMALIZED COST OF BORROWINGS DUE TO THE AVAILABILITY OF MEDIUM-TERM (10 YEARS) AND LONG-TERM (EXCEEDING 12 YEARS) BORROWINGS IN THE GERMAN, SWISS, AND JAPANESE CAPITAL MARKETS. THEREFORE, IT DOES NOT SEEM WARRANTED THAT, IN THE FACE OF SUCH CONDITIONS IN THE CAPITAL MARKETS THERE SHOULD BE AN INCREASE IN THE BANK'S LENDING RATE.

6. THE TREASURER ALSO SAID THAT THE INCREASE IN THE IBRD'S LENDING RATE AT THIS TIME CAN BE CONSIDERED AS THE RESULT OF THE RIGID APPLICATION OF ITS LENDING RATE FORMULA AND NOT AS A REFLECTION OF THE GENERAL CONDITIONS IN THE MAJOR CAPITAL MARKETS. IT WAS MAINLY DUE TO THE ABSENCE OF BORROWINGS IN THE SWISS AND GERMAN MARKETS. IN FACT, THERE WERE NO NEW BORROWINGS IN THE SECOND QUARTER (EXCEPT FOR THE ROLLOVER OF A BANK OF JAPAN LOAN) SO THAT THE PRINCIPAL DETERMINANT OF THE IBRD LENDING RATE OF 7.90 PERCENT WAS THE HYPOTHETICAL U.S. LONG-TERM BORROWING COST OF ABOUT 8.89 PERCENT. MOREOVER, IF THE IBRD'S FY

1978 BORROWING PROGRAM HAD BEEN SPREAD EVENLY OVER THE
FISCAL YEAR, ITS LIKELY LENDING RATE WOULD HAVE BEEN
POSSIBLE WITHIN THE RANGE OF 7.50 PERCENT TO 7.60 PERCENT
AS OF JANUARY 1, APRIL 1 AND JULY 1. EDMOND

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